

BUSINESS INTELLIGENCE BRIEF

October 25, 2018



NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **Government Spending Pushes Economy Forward** – Specifically it has been the rise in defense spending that has done the propelling. The increase was due to an increase in the purchase of aircraft and aircraft parts. This is one of the largest gains in years and has been attributed to the heavy use of air power in most of the conflicts the US has been engaged in. It has taken its toll on the aircraft used by all the military branches. There have also been new orders for new versions of planes that are scheduled for retirement. The defense sector has been boosting growth for some time now and that pattern will carry on into next year. The durable goods numbers will not look so good without this contribution and that may start to show up early next year as much of the aircraft ordering will have come to a temporary end.
- **Ball is in China's Court Now** – The US has indicated that it will not start talks with China until there is a firm proposal from the Chinese to respond to. This has not been the pattern with China in the past. It has often been the other way around with the US offering something and China choosing whether or not to snub it. The stronger negotiating position is to wait until the other side makes a firm offer and this is now what the US is seeking to evoke from China. The Chinese are not good at clarifying their position early and they will resent being in this position. The US now wants the opportunity to snub the Chinese and demand better and this puts the two nations at odds with one another.
- **Fed Gets Close to Technical Ceiling** – It has been the stated intent of the Fed to see the federal funds rate somewhere around 2.20% to 2.25%. The rates have been coming up officially but there are also other factors that drive the rates to some degree. The rates are now sitting at 2.20 and that is very close to the technical limit the Fed had set for itself. The federal funds rate is the rate they pay on reserves held at the Fed by commercial banks. This becomes the rate that banks use when loaning to each other and that underpins the whole lending system. The fact that rates have drifted to this point suggests that estimates of much higher rates next year might be premature. The rate hike planned for December looks secure enough but after that the outlook is a bit murkier.

Short Items of Interest – Global Economy

- **Trade wars, tariffs and the President's agenda** – The bottom line is that President Trump has chosen a segment of the US industrial economy to support even as other sectors will suffer from these policies. The manufacturers that have been struggling to compete with the outsourced options have welcomed the imposition of tariffs and trade restrictions on China. Those that need these imported items for their own production are deeply opposed. The fact is that China takes business away from US companies but it isn't clear that stopping China will change this dynamic much – US companies will just to see more Indian competitors as well as Latin America states.
- **South Africa Gets Hit from Many Directions** – The profligate policies of the Zuma years are coming home to roost in South Africa. The country is facing a major jump in its debt and deficit due to the sharp reduction in state revenue brought about by the recessionary conditions. This reduction in tax revenue would be bad enough but at the same time the country has increased wages and there has been excessive spending by state owned companies. Zuma promised a major wage hike in an attempt to win the contest and now that he is gone the hike remains in place with angry unions vowing to preserve it. The current government under Cyril Ramaphosa has been caught between a rock and a very hard place.
- **Brazil on Edge** – The race is all but over as Jair Bolsonaro is running away from his leftist opponent. His election is all but certain and this will provide the entire region with a shock. In the second round the voters in Brazil are asserting that Bolsonaro will do things that he has categorically denied he will do. They are simply asserting that he has changed and they are paying no attention at all to what he actually says.

Be the
smartest
person
at the
party.

For you.

Your clients.

Your
business.

Click the link
below for a
FREE TRIAL
of the
Black Owl
Report.

www.armada-intel.com/trial

Beige Book – Good News but Cautious Outlook

The Beige Book is a periodic “report from the trenches” that is produced by the Federal Reserve’s twelve districts and is meant to be a snapshot of the economy in the US as a whole. Each of the districts is asked to do a quick assessment of business conditions and to provide some opinion as to where they think their region is headed. It is not the kind of detailed and exhaustive research the Fed usually carries out – it is supposed to be much more current and impressionistic and relies heavily on the business people who sit on the local boards of these Fed districts. These reports tend to be a combination of reporting on what is happening right now and what the contributors think they see in the future. The latest version is a combination of optimism and caution as there was plenty of confidence expressed regarding the short term but some real fears about what the future will bring.

Analysis: Generally speaking there were three factors that figured into the good news part of the report. The first and most important is that employment is still very solid. The rate varies from one district to another but for the most part the US is enjoying a low rate of joblessness and that results in higher rates of consumer confidence. This translates into higher levels of retail activity and the twelve districts are all reporting that retail sales are on a decent pace although they are not as robust as many people had expected them to be in the wake of the tax cuts. On the other hand, the cuts were really not aimed at the consumer as much as it was at the corporate community and the response from business has been more pronounced. The hope had been that expanded business growth would result in better news for the consumer as there would be more hiring and higher wages. There has definitely been more hiring but the wage hikes have been lagging.

The second motivation seems to have been a temporary one and actually points to a bigger problem down the road. The business community has been rushing to get ahead of the tariffs and trade restrictions and that boosted growth for the last few months. Now that most of that activity has come to an end the impact on growth has been much reduced. The third motivator seems to be connected to the resurgence of the energy sector. The districts that encompass the energy regions reported solid growth but that might end up being short lived as the price of oil has already started to fall.

The future concerns have revolved around three factors as well. The first and most often cited has been the trade and tariff related issues. Many companies are now reporting higher prices for the things they need to produce. The price hikes are also starting to move through the system and will be hitting consumers harder in the months to come. Most of the companies that have seen higher input prices have elected to swallow the costs for the moment – they are more interested in hanging on to market share at this point. That position will be maintained for a limited period however and most have suggested they will be hiking their prices in the coming weeks and months. There are also the companies that are losing their overseas customers altogether as nations like China and those in the EU slap tariffs and trade restrictions on US goods in order to retaliate against US moves.

The second point of concern is inflation generally. The trade related inflation will start to combine with the more traditional motivators for higher prices – higher interest rates and higher wages. The Federal Reserve has not deviated one bit from its plan to hike rates and no amount of political pressure from the President or Congress will force a move. The rates are not shooting up drastically but they will be between 2.5% and 3.0% by the end of next year. The wage triggered inflation has been expected for some time as the usual motivator for higher wages is low unemployment. For a variety of reasons that has not happened as expected – at least not until right about now and the expectation is that it is a bigger issue next year.

The last of the general concerns that emerged from the Beige Book has just started to manifest. As of this writing the global markets have been swooning and the losses in just the last few days has erased the gains made thus far this year. The sense is that this is not yet the harbinger of a real correction but the mood of the investor is clearly not as buoyant as it was at the start of the year. There is a general feeling that economic progress may have peaked and the only direction from this point is down.

Timing is Everything

One of the more perplexing beliefs manifested by the majority of voters and politicians is that anybody really has that much control over the performance of the economy. It is not that government has no role to play as it is certainly obvious that taxes matter and so does what the government spends money on. The reality is that government essentially sets the stage for what happens when millions of consumers respond to millions of businesses. We insist on believing that there is more control over all this than is the case.

Analysis: The success that has been noted in the US economy began to manifest during the last of the Obama term and accelerated under Trump. This growth has been claimed by President Trump but it really is not his to claim (nor is it Obama’s). By most accounts the coming year will be more challenging and growth rates may well decline. If patterns are repeated, President Trump’s team will be blamed for that decline and it will not have all that much to do with his policies. The trade issue has been cited as the weak spot for the economy and that is President Trump’s policy but it is useful to remember that these tariffs are affecting less than 3.0% of the US GDP. The overall impact is negligible in part because all of the US export sector accounts for roughly 15% of the total GDP. The other 85% is rooted in domestic activity and that has been only tangentially affected by the trade disputes.

The Collapse of the MBS Reputation

The more that is revealed regarding the assassination of Jamal Khashoggi the more bizarre this whole incident becomes. The impact on Saudi Arabia has already been profound but it is expected to get far worse as the months drag on. The man at the center of all this is the Crown Prince – Mohammad bin Salman (MBS). He has been hailed as the new face of the Saudi royal family and was rapidly becoming the darling of the western world for his seeming commitment to reform and progress. It has been under his direction that women have been making slow progress in Saudi society – gaining the right to drive and to vote and otherwise participate in the civil affairs of the country. Although his father remains King, the Crown Prince has been granted an enormous amount of power. His number one mission seemed to be shifting the economy from its dependence on oil and that has spurred western investment into the country as MBS plunged ahead in his quest to diversify the economy. All of this is now challenged by the events of the last few weeks.

Analysis: It is almost beyond understanding. In what way could Jamal Khashoggi have been such a threat to MBS that his murder would be suggested – much less carried out. He was an ardent critic of the Crown Prince as a columnist for the Washington Post but it was not as if any of these criticisms had slowed the interest in Saudi Arabia. He had next to no voice in Saudi Arabia itself and even those who counted themselves followers of the Post barely recognized the name. He was a gadfly to be sure but was no threat in any real sense. It is now obvious that he was lured to the consulate in Turkey and murdered. The half-baked stories and lame assertions have been disproved one after another and MBS is connected very directly.

It has now been revealed that US and western intelligence agencies have been suspicious of the Crown Prince since his elevation by the King. The man who was the intelligence chief in Saudi Arabia was Mohammed bin Nayef and he was well respected and trusted by the allies in Europe and the US. He was a steady hand and he seemed to have a grasp of where Saudi interests coincided with those in other nations. The knock on MBS was that he was headstrong, reckless, egomaniacal and utterly intolerant of dissent. His expectation was that he would be loved by his people for all the reform efforts he made and that he would likewise be loved by the western nations for his efforts to thwart the machinations of Iran and terrorism in general. As has happened so many times in history, the love that reformers expect is rarely granted.

The reaction to the reforms in Saudi Arabia has either been overtly hostile or they have been frustrated. The traditional Saudi society has been horrified by the actions freeing women to get engaged with society and the women themselves have been less grateful and more annoyed that it has taken this long as they demand more rights and privileges. The western reaction has been mixed as well – praising one day and complaining about high oil prices the next. These reactions have annoyed MBS and his reactions have been petulant. His adventures in Yemen have been roundly condemned by those in and out of Saudi Arabia and that quagmire has become the most serious thorn in his side. It has been humiliating that his army has failed to route an insurgency made up of poor Houthi minorities and he has bristled at the critique that has been leveled at him.

Everything now seems to be unraveling. His father has started to engage and looks set to reduce his authority and those that have opposed his reforms in the country are gaining more support. His western friends have backed away and are unlikely to reengage as long as this issue remains. The death was very badly handled and it seems that MBS was utterly naïve when it comes to Turkey and its intelligence service. They see Saudi Arabia as a threat and monitor them as such. They have details regarding the assassination that have torn gaping holes in the Saudi explanations.

Georgia's Nasty Electoral Politics

The country has been through a great deal since it split from the USSR. As the birthplace of Josef Stalin (Djugashvili) it had a special place in the old Soviet Union but upon gaining independence it has been torn by those who want the state to ally with the western powers and those who want connections with Russia. It also has deep ethnic divisions with semi-independent regions expected to get along with the rest of the country. The Russians have invaded Georgia and threaten to do so again.

Analysis: The election is coming soon and the country is divided over whether to stay connected to the west. The leading candidate is Salome Zurbashvili- once the French ambassador to the country. She is the daughter of Georgian immigrants to France who was given citizenship by the former President – Mikhail Saakashvili. He now calls her a traitor and is backing an opposition candidate.

What Else Can You Get from Armada?

As you peruse the Business Intelligence Brief you are no doubt wondering what else you might get from the authors of these reports. You are in luck as the BIB is not our sole publication. There is the Black Owl Report – published three times each week and aimed at the business executive. Keith Prather is the primary writer for the BOR and you can get a free one-month trial if you like. It is a subscription-based publication available for \$84 a year. In addition to these regular reports we do longer in-depth studies, white papers and analysis of breaking economic and business stories. Beyond all that we like to be responsive to our readers and regularly answer questions posed by our readers – just e-mail chris.kuehl@armadaci.com for more details or to ask one of those questions.

Politics Has to Change

It really has to but I am quite sure that it will not. The complaint every year is that not enough of us exercise our rights to vote and this lack of engagement is decried. But seriously, who would want to be part of this cacophony of screaming, red-faced invective. Here is rarely even a mention of what a given candidate intends to do and how – it is drowned out by hurled insults and slams to the point that we believe we are being asked to choose between two crooks. The vast majority of the attacks are wholly unjustified and have absolutely nothing to do with the job they are ostensibly seeking to do. This has to stop but it won't.

We are losing faith in everything we once held dear. We don't trust politicians as far as we can throw them and we have become equally disillusioned by religious leaders, school leaders and community leaders. We focus only on their failures as people or on issues from their past and pay no attention to what they assert now. I understand that we are all creatures of our past but I know full well that we all grow over time. I am not the same person I was 10, 20 or 30 years ago and neither is anyone else. We want people to lead us and then we rip them to pieces so that they can't.

Poll after poll indicates the same set of real concerns for the average person and yet these issues scarcely appear in the campaigns and when they do there is never more than a vague platitude. Top of the list for many is drugs and the opioid crisis but all we hear is that it is indeed a crisis. Solutions anyone? None to be found as they all cost money – lots of money. Everyone talks of creating jobs. How exactly? And how about the millions of jobs that can't be filled as people are not qualified? Solutions anyone? Oh yeah, training costs money and so we will blather on about something else.

Five Things You Can Do with the Business Intelligence Brief

- 1) **You can share the BIB with anyone you would like to. We encourage it. Distribute this to members of your staff and organization, send it to your friends and family. The whole idea of the BIB is to help people stay informed and to think about the many issues that affect the way the US and global economies function.**
- 2) **You can excerpt pieces from the BIB as well. Many of you have your own publications and newsletters and we are more than willing to share. If you do decide to run all or part of the BIB in your own publication we simply ask that you give us credit. It would be great to see how you share us.**
- 3) **You can interact with the BIB. This is a one-author publication. It is written by Chris Kuehl and any comments you make will go to him. If you like something you read – he welcomes the feedback but he also likes the critiques. If you have questions that come up and you want more information or clarification please just write to chris.kuehl@armadaci.com**
- 4) **You can help us expand our distribution by calling other's attention to the BIB. We have organizations all over the world that distribute the BIB and many businesses do as well. It is only \$100 a month to be able to send the BIB to anyone you wish in a version that carries your logo and information. Ask ksanchez@armadaci.com for more details on this**
- 5) **You can advertise in the BIB. The space taken up by this message can be used for your message to the readers of the BIB. You also get control of the front-page banner. This is \$100 a week and there are discounts for multiple weeks. Contact Karen about this option – ksanchez@armadaci.com**



ARMADA

The Business Intelligence Brief (BIB) is prepared by Armada Corporate Intelligence (Armada) exclusively for the membership of the Greater Kansas City Chamber of Commerce (The Chamber), through an agreement between Armada and Chamber Management Services, LLC (CMS). Neither CMS nor The Chamber assumes any responsibility for the editorial content, and any such editorial content shall not be construed as an official position of either CMS or The Chamber. Armada has taken all reasonable steps to verify the accuracy of the content of the information in the BIB, and therefore, Armada shall not be responsible for any errors or omissions.

[Type here] Armada Staff –Chris Kuehl, Keith Prather, Karen Sanchez

P.O. Box 733 – Lawrence, Kansas 66044 – intel@strategic-briefs.com